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IN THE

SUPREME COURT
OF THE
UNITED STATES

October Term, 1986

McCLELLAN REALTY COMPANY, et al.,

Petitioners,

v.

UNITED STATES OF AMERICA, et al.,

Respondents.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Third Circuit

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Dated: January 22, 1987

40pp

QUESTION PRESENTED

Where a mortgage is received by a lender for a fair equivalent of the cash it loaned in an arms-length transaction to a mortgagor, is it erroneous for the Court of Appeals to void as a fraudulent conveyance the security interest on the basis of its determination that the mortgagor did not receive a fair equivalent from the parent to which the mortgagor passed a portion of the loan proceeds upstream in connection with a leveraged buy-out?

P A R T I E S

The Defendants - Petitioners, in addition to McClellan Realty Company, are Jeddo Highland Coal Co., Pagnotti Enterprises, Inc., Loree ASsociates, Gillen Coal Mining Co., Carbondale Coal Co., Moffat Premium Anthracite, Northwest Mining, Inc., Maple City Coal Co., Powderly Corporation, Clinton Fuel Sales, Inc., Olyphant Premium Anthracite, Inc., Olyphant Associates, Minindu Corporation, Gilco, Inc. and Joseph Solfanelli, Individually and as Trustee.

The Respondents are the Plaintiff, United States of America, the Defendants Commonwealth of Pennsylvania, the Trustee in Bankruptcy of Blue Coal Corporation, and Glen Nan, Inc., Tabor Court Realty Corp., James J. Tedesco, Henry Ventre, Louis Pagnotti, II, Raymond Colliery Co., Inc., Great American Coal Co., General Electric Credit Corp., Commonwealth of Pa. Dept. of Mines & Mineral Industries, Dept. of Environmental Resources and Dept. of Revenue, Borough of Olyphant, John J. Gillen,

Thomas J. Gillen, Robert W. Cleveland & Sons, Inc., William T. Kirchoff, Jay W. Cleveland, Royal E. Cleveland, City of Scranton Sewer Authority, Lackawanna River Basin Authority, Borough of Taylor, Lackawanna County, William R. Henkleman, Gleneagles Investment Co., Inc., Jay W. Cleveland, as Administrator of the Estate of Royal E. Cleveland.

McClellan Realty Company is wholly owned by its parent Pagnotti Enterprises, Inc. McClellan Realty Company has one subsidiary, Cracker Coal Corporation. Affiliate companies are:

Pagnotti Coal Company
Verto Corporation
Universal Television Cable Systems, Inc.
Jeddo-Highland Coal Co.
Lehigh Valley Coal Sales Co.
Sullivan Trail Coal Company
Sullivan Trail Mfg. Company
No. 1 Contracting Corporation
Lackawanna Casualty Co.
PTV Corporation
Indian Head Coal
Best Black Coal Co.
Black Coal Corporation
Loree Associates - Partnership
Tabor Court Realty, Inc.
Gordan Land Company
Nagle Corporation
Natural Coal Company
Canal Coal Company
Lost Creek Coal Company
Davlish Enterprises, Inc.
Mary Robert Realty Company

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Opinions Below.

The May 20, 1983, opinion of the District Court is reported at 565 F. Supp. 556 and is appended hereto as Exhibit *A*.

The September 13, 1983, opinion of the District Court is reported at 571 F. Supp 935 and is appended hereto as Exhibit *B*.

The April 10, 1984, opinion of the District Court as corrected May 16, 1984, is reported at 584 F. Supp 671 and is appended as Exhibit *C.*

The March 26, 1985, final order and judgment of the District Court is appended as Exhibit D.

The October 22, 1986, opinion of the Court of Appeals is reported at 803 F.2d 1288, and is appended as Exhibit E.

The October 24, 1986 order amending opinion of the Court of Appeals is appended as Exhibit F.

The November 24, 1986 order of the Court of Appeals denying the petition for rehearing is appended as Exhibit G.

JURISDICTION

The Court of Appeals for the Third Circuit filed an opinion and entered judgment on October 22, 1986. On November 5, 1986, a Petition for Rehearing and for Rehearing In Banc was filed by McClellan Realty Corporation and other Defendants. On November 24, 1986, the Court of Appeals entered an Order denying both petitions. Jurisdiction is conferred upon this Court by 28 U.S.C. § 1254(1).

CONSTITUTIONAL PROVISIONS, ACTS, STATUTES, AND RULES AND REGULATIONS INVOLVED

Uniform Fraudulent Conveyance Act, 39 P.S.A. §§351-360; 11 U.S.C. §548, §550.

INTRODUCTION

This case presents the first significant application of the Pennsylvania Uniform Fraudulent Conveyance Act, 39 Pa.Stat. §351, *et seq*. (hereinafter the "Act" or the UFCA) to a leveraged buy-out financing. The United States brought this action: (a) to reduce to judgment and collect certain alleged delinquent federal income taxes, interest and penalties assessed and accrued against Raymond Colliery Co.,Inc. and its subsidiaries (hereinafter referred to as the "Mortgagors" or the "Raymond Group"); (b) to foreclose its tax liens and to sell property owned by the Mortgagors; and, (c) to assert the priority of its liens over liens held by other claimants named as defendants herein.

Appellants submit this Petition in support of their appeal from the judgment by the Court of Appeals for the Third Circuit affirming in part and reversing in part the final Order and judgment of the District Court for the Middle District of Pennsylvania entered March 26,

1985, in separate decisions, each entitled United States v. Gleneagles Inv. Co., Inc. The first, at 565 F. Supp. 556 (1983) ("Gleneagles I"), invalidated mortgages made in connection with a leveraged buy-out; the second, at 571 F. Supp. 935 (1983) ("Gleneagles II"), refused to uphold the validity of the mortgages in the hands of the assignee; and the third, at 584 F. Supp. 671 (1984) ("Gleneagles III"), determined, inter alia, the priority of lienors.

STATEMENT OF THE FACTS

A. The Parties

This is an action brought under the UFCA to set aside mortgages made by four corporations engaged in the coal mining business -- i.e., the Mortgagors, Raymond Colliery Co., Inc., Blue Coal Corporation, Glen Nan, Inc. and Olyphant Associates -- as well as certain guarantee mortgages made by Mortgagors and their interrelated associated companies, collectively referred to by the District Court as the Raymond Group. The mortgages were granted

on November 26, 1973, to Institutional Investors Trust ("IIT"), a company listed on the New York Stock Exchange, and an affiliate of Donaldson, Lufkin & Jenrette, and assigned by IIT on January 26, 1977 to appellant McClellan Realty Co. ("McClellan"). The creditors also sought to deny McClellan, as assignee, the right to enforce the mortgages it received from IIT.

Mortgagors were related companies: Glen Nan was a wholly-owned subsidiary of Blue Coal, which in turn was a wholly-owned subsidiary of Raymond Colliery. Raymond Colliery's principal shareholders are individuals who were also principal shareholders of the fourth Mortgagor, Olyphant Associates (Gleneagles I at p. 563, findings nos. 13 and 14). Other members of the Raymond Group include subsidiaries of Mortgagors and subsidiaries of such subsidiaries. The Raymond Group was engaged primarily in coal production and sale of surplus lands. At the time of the mortgage loan and for years prior thereto, Blue Coal was either

the largest or one of the largest anthracite coal producing companies in the United States. (Gleneagles I at pp. 563, 564, findings nos. 17 and 19.)

The stock of the Raymond Group was owned by members of two families surnamed Gillen and Cleveland ("the shareholders"). Members of the two families were controlling officers and directors of the Raymond Group (Gleneagles I at p. 563, findings nos. 3, 4, 5 and 16). When disagreement arose among the shareholders concerning the operation of the Raymond Group, a decision was made to sell all their stock (Gleneagles I at p. 563, finding no. 41). After searching for a buyer, the shareholders issued an option to buy the stock to James Durkin. After obtaining two extensions on his option, Durkin formed a holding company, Great American Coal Company ("Great American"), transferred the option to Great American and continued with other principals of Great American to seek financing for the stock purchase (Gleneagles I at p. 656, findings nos. 45, 50

and 51).

During the summer of 1973, a loan broker brought together Great American and IIT, a New York City-based independent lender unrelated to any party to the transaction (Gleneagles I at p. 566, findings nos. 67, 68 and 69). In the fall of 1973, IIT issued a loan commitment, and after negotiations leading to a loan agreement, a leveraged buy-out was effected. It was in this connection that Mortgagors executed the Mortgages and that the Raymond Group executed mortgage guarantees which are the subject of this Petition.

B. The Mortgage Loans and Leveraged Buy-Out

Mortgagors executed the notes and mortgages in connection with the leveraged buy-out financing on November 26, 1973, more than three years prior to an assignment of the mortgages to McClellan. IIT made four separate mortgage loans to Mortgagors aggregating $8,530,000 (Gleneagles I at p. 568, finding no. 104). Of this sum, $1,530,000 was retained by IIT as an interest reserve, and

$7,000,000 was actually remitted to Mortgagors as follows: $2,590,000 was loaned to Raymond Colliery, $4,270,000 was loaned to Blue Coal, and $70,000 was loaned to each of Olyphant and Glen Nan (<u>Gleneagles I</u> at p. 568, finding no. 104). IIT was represented at the mortgage closing by the law firms of Morgan, Lewis and Bockiue and Fried, Frank, Harris, Shriver and Jacobson (<u>Gleneagles I</u> at p. 567, finding no. 85). Durkin, as well as Great American and its shareholders, were represented by Rosenn, Jenkins & Greenwald. Other participants in the financing were similarly represented by independent counsel (<u>Gleneagles I</u> at p. 567, findings nos. 84, 85 and 86).

In a separate and distinct part of the leveraged buy-out of Raymond Colliery by Great American, Mortgagors loaned $4,085,000 of the proceeds of the mortgage loans to Great American, which executed unsecured notes in consideration therefor. The balance of the purchase price was obtained by James Durkin, a principal shareholder of Great American, who arranged

for additional loans to Great American in the amount of $3,452,250, supplied by thirteen separate lenders unconnected in any way with IIT (Gleneagles I at p. 567, finding no. 80). Thus, of the $7,000,000 in loans proceeds received by the Mortgagors, approximately 42 percent, or $2,915,000, was used for purposes unrelated to the leveraged buy-out, to pay existing obligations to creditors; and of the aggregate sum of $7,537,250 loaned by all sources to Great American for the leveraged buy-out, only $4,085,000 or 54 percent, was received in loans from Mortgagors.

Great American used the funds that it received from Mortgagors and other lenders to purchase stock held by the principal shareholders of Raymond Colliery, thereby acquiring control of Raymond Colliery and all of its subsidiaties.

The creditors in this litigation sued to recover the sums paid to the shareholders whose stock was purchased by Great American in 1973 leveraged buy-out. The actions were

settled and the creditors recovered more than the $4,085,000 originally paid from the IIT loan proceeds (through Great American) to buy out the shareholders. The shareholders paid the creditors a total of $6.1 million -- $3,330,000 was paid to creditors of Raymond Colliery, $2,692,000 was paid to creditors of Blue Coal, and $78,000 was paid to creditors of Glen Nan (Gleneagles III at p. 679, findings nos. 479 and 480).

REASONS FOR GRANTING THE WRIT

There exists presently a conflict between the Court of Appeals for the Third Circuit and the Court of Appeals for the Eleventh Circuit in the interpretation of the fair equivalence standard set forth in both the Uniform Fraudulent Conveyance Act and the Bankruptcy Code in the context of a multiple party leveraged acquisition. If the multiple transactions are permitted to be collapsed, as the Court of Appeals has done here, the lender who parted with a fair equivalent in exchange for a lien

of equal value is deprived of its lien and the creditors who have already recouped their losses from the beneficiaries of the transaction, the selling shareholders, are permitted to collect double damages through lien avoidance. The Supreme Court should resolve the conflict in favor of the interpretation given the fair equivalence standard of Section 548 of the Bankruptcy Code by the Court of Appeals for the Eleventh Circuit in In re Greenbrook Carpet Co., 722 F. 2d 659 (11th Cir. 1984).

A. Introduction

The common law of fraudulent conveyances was rooted in the Statute of 13 Elizabeth, which condemned conveyances made with the "intent" to "hinder, delay or defraud" creditors. 13 Eliz. ch. 5(1571). Recognizing the difficulty of determining actual intent to defraud and the need to reach some transactions which deplete an estate when intent to defraud does not exist, the common law courts developed a list of fact patterns, or "badges of fraud",

that resulted in presumptions of actual fraud. Prefatory Note, UFCA, 7A U.L.A. 428 (1985).

The UFCA retains a condemnation of intentional fraud, but requires actual intent "as distinguished from intent presumed in law". Pa. Stat. Ann. tit. 39, §357 (Purdon). These "constructive fraud" provisions of the UFCA are narrowly drawn. They do not prohibit commercial intercourse with financially troubled entities. They are designed simply to discourage people from obtaining an insolvent debtor's assets without giving commercially equivalent value in exchange, and thereby depleting the debtor's estate at the expense of creditors.

Section 4 of the UFCA, as enacted in Pennsylvania, provides:

> "Every conveyance made and every obligation incurred by a person who is or will be thereby rendered insolvent, is fraudulent as to creditors, without regard to his actual intent, if the conveyance is made or the obligation is incurred without a fair consideration." Pa. Stat. Ann. tit. 39, § 354 (Purdon).

Thus, this section requires three separate

inquiries:

(i) Whether the transferee has exchanged property of "fair equivalent" value in exchange for the debtor's property transferred in the transaction;

(ii) Whether the debtor was "insolvent" at the time or as a result of the exchange;

(iii) Whether the transferee acted in "good faith" in connection with the transfer.

The Court of Appeals resolved each of these issues against IIT, the lender that provided secured financing for the leveraged buyout in this case. In doing so, however, the Court misinterpreted the meaning of "fair equivalence," "insolvency" and "good faith". In each case, the Court of Appeals rejected simple and long-settled definitions of these terms of art in favor of a vague, expansive and misguided application of the statute.

B. <u>The Exchange of $8.53 Million in Cash for $8.53 Million in Secured Notes Was a "Fair Equivalent" Exchange. It Did Not Deplete the Estates Available to the Creditors</u>

Prior to the <u>Gleneagles I</u> decision, the matter of "fair equivalence" involved a straightforward question of relative values. In cases involving conveyances without consideration, for nominal consideration, or for illegal consideration, the finding of no equivalence is relatively obvious. On the other hand, where <u>some</u> property has been exchanged in the transaction, careful consideration of the evidence concerning the value of the property exchanged by each party is required.

C. <u>Fair Consideration Was Received by Mortgagors From IIT In Exchange for the Mortgages</u>

One of the bases for the conclusions that the mortgages were void as fraudulent conveyances under §§ 354, 355 and 356 of the Act is the Court of Appeals' affirmance that IIT did not give fair consideration therefor. This holding was made by considering the Mortgagors and their related companies as only one entity

and by collapsing two separate loans into one transaction. There were, in fact, two separate transactions and each should stand or fall on its own merits.

In the transaction that is the subject of this Petition, IIT made loans of $8,530,000 (in an arms-length transaction free of any collusion) to Mortgagors (i.e., four separate mortgages to four separate entities), which executed notes, the aggregate sum of which amounted to $8,530,000, and mortgages, to secure the same. Pursuant to the loan agreement, $1,530,000 was retained by IIT as an interest reserve and $7,000,000 was actually distributed to Mortgagors. The mortgages secured the payment of $8,530,000. Manifestly, Mortgagors received a fair equivalent in consideration from IIT for the notes and mortgages that they executed. The District Court did not hold otherwise.

The error committed by the Court of Appeals was its failure to pass upon the fairness of this transaction. Instead, it penalized IIT

for the Mortgagors' subsequent use of the loan proceeds. The Court of Appeals focused upon the Mortgagors' subsequent loan of $4,085,000 (from the $7,000,000 mortgage loan proceeds) upstream to the parent holding company, Great American, in exchange for unsecured notes in that amount -- notes which the Court of Appeals found were not likely to be paid because Great American's ability to generate funds depended entirely on the operations of Mortgagors and related entities.

By focusing on the notes that Mortgagors received from their <u>parent</u>, instead of the cash that Mortgagors received from the <u>lender</u>, IIT, the Court of Appeals held that Mortgagors did not receive a fair equivalent in exchange for the mortgages to IIT. The Court of Appeals equated IIT's knowledge of Mortgagors' poos financial condition (as erroneously found by the District Court) to bad faith in the mortgage loan transaction. In so holding, the Court of Appeals erroneously ignored the fact that <u>Mortgagors did receive a fair equivalent</u>

in cash from IIT in exchange for the notes and mortgages, and that the IIT transaction with Mortgagors was clearly at arms length and not collusive. By collapsing the transaction, the Court of Appeals penalized the lender, IIT, because IIT failed to police the borrowers' subsequent use of funds given as part of what was, incontrovertibly, an arms-length transaction, and because IIT made loans to ailing business entities in need of the same. The "Catch 22" effect of the Court of Appeals' decision is to permit lenders to make secured loans safely only if the borrower does not need a loan. Such an application of the Act flies in the face of the law and good economic sense. Greenbrook, supra.

In Greenbrook, the court was applying the constructive fraud provisions contained in §548(a)(2) of the Bankruptcy Code. These provisions are a "federal codification" of §§ 4 and 5 of the UFCA, and are to be consistently construed to the extent they are parallel. See Cohen v. Sutherland, 257 F. 2d 737, 741

(2d Cir. 1958); see also 4 COLLIER ON BANKRUPTCY ¶548.01[2] (15th ed. 1979).

In Greenbrook, a case directly in point, a leveraged buy-out was arranged after a lender refused to make a loan to principals of Greenbrook Carpet Co., who wished, individually, to buy a controlling interest in another company. The loan was refused because the collateral offered by the individuals was inadequate. Instead, the elnder agreed to make the loan to Greenbrook for a security interest in its property. And Greenbrook, in a second step, transferred all the loan proceeds to the principals, who thereupon executed a note and used the proceeds as they originally planned -- *i.e.*, to buy a controlling interest in the other company. The lender was aware of the ultimate use to which the funds would be put. Greenbrook was subsequently adjudicated bankrupt. The court refused to permit the trustee in bankruptcy for Greenbrook to set aside as a fraudulent conveyance the security interest given by Greenbrook to the lender. The court

held:

> "Although the bank knew the intended use of the funds, this does not necessarily render the transfers invalid under section 548(a)(2). The bank could properly loan Greenbrook funds knowing Greenbrook would use the funds for a speculative venture. The issue under section (a)(2) [fair consideration] is whether the bank received more consideration than it was due; if the transaction between Greenbrook and the [principals] constituted a fraudulent transfer, the trustee may sue the [principals]. Id. at 661 (emphasis in original).

Similarly, here, the issue under §353 of the Act is whether IIT received more consideration than it was due. Indisputable it did not. Moreover, if the transaction between the Mortgagors and Great American (or its shareholders) constituted a fraudulent transfer, the respondent creditors may sue Great American and its shareholders, who were the persons who received the benefit of that transfer. Indeed, suit was filed against the selling shareholders, and by settlement, restitution was made. To invalidate the mortgages because, according to the Court of Appeals, the loans were made to financially ailing

businesses, is to chill the prospect of entities seeking to revitalize by obtaining financing, or to escape bankruptcy. Such an application of the Act is contrary to public policy and good economic sense. Clearly, the law cannot require a lender to guarantee the success of the borrower, or to control the borrower's use of loan proceeds as the price for a valid security interest taken in connection with a loan.

In holding that IIT lacked good faith in making the loan to Mortgagors, the Court of Appeals has effectively read the good faith requirements for fair consideration out of §354 of the Act. Under §354, a conveyance or obligation is void as fraudulent, if made (a) to a person who is or will be rendered insolvent, <u>and</u> (b) without a fair consideration.

Fair consideration is defined by §353 of the Act to require two elements -- an exchange of a <u>fair equivalent</u> made in <u>good faith</u>. The District Court held that IIT failed to act in good faith because:

"[1] IIT knew or strongly suspected that the imposition of the loan obligation secured by the mortgages... would probably render insolvent both [Mortgagors and their affiliated companies] and each individual member thereof; [and] [2] In addition, IIT was fully aware that no individual member of [Mortgagors and their affiliated companies] would receive fair consideration within the meaning of the Act in exchange for the loan obligations to IIT. Gleneagles I at p. 574.

McClellan has already demonstrated how the second of these findings is improperly premised upon collapsing two separate loan transactions into one. With respect to the first of the above two findings, the Court of Appeals has concluded that any time a lender makes a loan to a debtor whose balance sheet shows a potential or existing insolvency, that fact, in and of itself, is sufficient under §354 of the Act to invalidate any security interest taken by the lender should the borrower later fail. In other words, the Court of Appeals equates knowledge of potential or existing insolvency with lack of good faith. Under this analysis, the Court of Appeals would

invalidate every work-out and every transaction designed to rescue a party from bankruptcy even where, as here, the lender proceeds in perfect good faith -- <u>i.e.</u>, the lender is motivated solely by the desire to make a reasonable profit and deals in every respect at arms-length with the borrower, without collusion or oppression. In consequence, it was wrror for the Court of Appeals to equate lack of good faith (and therefore lack of fair consideration) with knowledge of potential or existing insolvency.

It is submitted that such a reading of the Act is inconsistent with the intention of the Commissioners and with common sense. If lenders are put into a position where loans to ailing or failing companies are made at their peril -- <u>i.e.</u>, if good faith is to be equated with their lack of knowledge of the borrower's ailing financial condition -- such loans will be few and far between and the financing of industry will be curtailed substantially. Inasmuch as there <u>was</u> both a fair equivalent and

good faith, there was fair consideration exchanged by IIT and the Mortgagors. In consequence, the mortgages may not be invalidated under §§ 354, 355 or 356 of the Act.

D. Effect of Collapsing Theory

A major purpose of the UFCA is to give creditors a right to set aside any conveyance which fraudulently dissipates the debtor's estate. Newman v. First National Bank of East Rutherford, 76 F. 2d 347, 350 (3d Cir. 1935). Mortgagors' creditors sued to recover the sums paid to the shareholders whose stock was purchased by Great American in the 1973 leveraged buy-out. The actions were settled and the creditors recovered more than the $4,085,000 originally paid from the IIT loan proceeds (through Great American) to buy out the shareholders. The shareholders paid to the creditors a total of $6.1 million -- $3,330,000 was paid to creditors of Raymond Colliery, $2,692,000 was paid to creditors of Blue Coal, and $78,000 was paid to creditors of Glen Nan (Gleneagles III at p. 679, findings nos. 479

and 480). Yet the Court of Appeals refused to apply any portion of the sums paid in settlement to reduce the recovery to which the creditors would otherwise be entitled in this litigation.

The District Court found (Gleneagles III at p. 682) that the $6.1 million was paid by shareholders to settle not only the litigation flowing from the leveraged buy-out, but also to satisfy the same creditors upon claims made in other lawsuits. However, the fact is that shareholders were involved in two other lawsuits. In one, the shareholders had been grantees of land that, pursuant to their settlement with creditors, they agreed to return for the benefit of creditors. And the other, insofar as the shareholders were concerned, was the state court analog of the litigation here tried to the District Court. Consequently, to the extent shareholders previously paid money to creditors in settlement of other litigation, the payment was made for the same claims raised in this litigation. In reality,

therefore, the $6.1 million paid by shareholders <u>was</u> a payment to creditors to settle the very claims brought against shareholders in this action. In any event, equity requires that an opportunity be given Mortgagors to fix the sum given in restitution with such greater precision as the District Court may require.

Moreover, even though the Court of Appeals acknowledged that $2,915,000, or approximately 42 percent, of the IIT loan proceeds originally went for the benefit of Mortgagors' creditors, IIT and McClellan received no credit therefor in regard to the partial validity of their liens.

In failing to take account of this approximately $9,000,000, which indisputably has gone to the benefit of Mortgagors' creditors, the Court of Appeals has ignored the principles of the UFCA as expressed in <u>Newman v. First National Bank</u>, <u>supra</u>. Surely creditors are entitled, even if the conveyances had been fraudulent under the UFCA, to set aside security interests in no more than the $4,085,000,

plus interest, from November 26, 1973, which the District Court held was improperly diverted away from creditors for the benefit of the selling shareholders. To hold that Mortgagors' creditors are entitled not only to the benefit of the $9,000,000 applied for their benefit, but also to the benefit of the real properties stripped of the mortgage liens, is to put creditors in a better position than they would have been prior to the "fraudulent transfers". The District Court decision improperly gives the creditors a double recovery to satisfy a single claim.

Even if, arguendo, there were a portion of the loan used improperly for the leveraged buy-out and which gives rise to fraudulent conveyance relief under the Act, justice and the principles of fraudulent conveyance law require that the lender not be deprived also of that portion of the security representing loan proceeds actually used for the benefit of creditors and clearly outside the fraudulent conveyance provisions of the Act. See

Roxbury State Bank v. The Clarendon, 324 A.2d 24 (N.J. Super. 1974). Thus, even under circumstances constituting a fraudulent conveyance, a lender retains its lien to the extent that its loan proceeds were used to satisfy the debtor's creditors. Taylor v. Kaufhold, 379 Pa. 191 (1954); Amadon v. Amadon, 359 Pa. 434 (1948); Patterson v. Missler, 238 Cal. App. 2d 759, 48 Cal. Rptr. 215 (1966). Analogous provisions in the Bankruptcy Code include a statutory single satisfaction rule. The fraudulent conveyance provisions of the Code are modeled on the UFCA, and uniform interpretation of the two statutes is essential to promote commerce nationally. Cohen v. Sutherland, 257 F. 2d 737, 741 (2d Cir. 1958); 4 COLLIER ON BANKRUPTCY, Section 548.01 (15th ed. 1979). Section 550 of the Bankruptcy Code (11 U.S.C. §550) provides the trustee in bankruptcy with the right to recover, or set aside for the benefit of the debtor's estate, transfers of property which were fraudulently conveyed by the debtor. And §550(c) states that

"the trustee is entitled to only a single satisfaction" in connection with the avoidance of any transaction.

The wrong committed upon the creditors here, according to the Court of Appeals, is the diversion of some 58 percent of the loan proceeds from the IIT loan to Mortgagors' shareholders. Accordingly, the creditors are entitled to no more than a 58 percent (adjusted for interest since November 26, 1973) interest in the mortgaged property. The Court of Appeals' invalidation of the mortgages in their entirety gives the creditors the benefit of not only the mortgaged property in its entirety, but also the benefit again of 42 percent of the IIT loan proceeds previously applied in 1973 to pay existing creditors and the significant sum paid by shareholders to settle the UFCA claim against them. In consequence, the creditors are presumably made whole by the invalidation of the mortgages and then given a bonus of a second recovery from the other sources -- <u>i.e.</u>, a multiple recovery despite

a single alleged wrong. This should not be sanctioned by the law.

E. Policy Consideration

The Court of Appeals' decision is also inconsistent with fundamental considerations of equity and sound policy. If multiple transactions may be collapsed into a single transfer for the purpose of calculating the equivalence of exchanges under the UFCA, the lender in effect becomes the insurer of the debtor's insolvency for an indefinite time period. Among the buyer, the seller and the lender, however, the lender has the least access to information about the debtor's solvency and the values exchanged in the upstream transfers. See Gleneagles I, 565 F. Supp. at 581. In addition, of all the participants in the transaction, the potential benefits to be derived from the leveraged buy-out are the most marginal (interest only) for the lender. While the seller gains cash in exchange for his ownership interest, and the buyer gains ownership of the debtor in a leveraged situation, the

lender gains only the opportunity to earn a competitive market rate of interest on the loan. Under the Court of Appeals' analysis, however, the lender loses the entire value of its secured loan in the event the debtor's upstream transfers turn out to be a technical graudulent conveyance. The actor with the least information, the least reason to encourage a voidable transfer, and the least to gain is hardly the person to whom creditors should look for a remedy. It cannot be denied that a fraudulent transfer can occur in the context of a leveraged buy-out. If it does, however, it is the buyer and the seller, the parties who actually receive the transfers, who have depleted the debtor's assets.

This is not to suggest that parties who participate in the making or obtaining of fraudulent conveyances may never be liable for tortious conduct to creditors of the debtor transferor. As the District Court recognized, the buyer and the seller, who receive the real benefits from the leveraged buy-out, will

remain liable to the creditors under the UFCA and under general fiduciary principles of corporate law. Gleneagles I, 565 F. Supp. at 583-85. Moreover, under the laws of some states, including Pennsylvania, parties may be held liable for knowingly aiding and abetting, actively encouraging or participating in an actual -- but not constructive -- fraud. Thus, traditional legal theories provide creditors with ample protection in the event that a lender is truly engaged in fraud as distinguished from an ordinary commercial loan transaction.

CONCLUSION

This Court should grant the Petition for Certiorari to resolve these fundamental and important issues.

Respectfully submitted,

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